February 7, 2003

TO: Merritt D. Long, Chairman
Vera Ing, Board Member
Roger Hoen, Board Member
Pat Kohler, Administrative Director

CC: Rick Garza, Deputy Administrative Director

FROM: Lorraine Lee, Director, Licensing & Regulation

SUBJECT: AIA Formula Worksession

This memorandum summarizes the outcome of the Alcohol Impact Area (AIA) formula worksession held on January 10 and 17, 2003.

Purpose and Participants
The worksession was convened for the purpose of exploring a formulary approach to production restrictions under the AIA rules. Participants included representatives from the industry and the cities of Seattle and Tacoma. (Worksession minutes are attached.)

At the start of the worksession, I emphasized that the worksession was intended to provide an opportunity for everyone to come together, present their views, and collectively explore the feasibility of using a formula as a means of restricting certain alcohol products in an AIA. I also noted that a formulary approach – which would include the elements of alcohol content and price -- has been a longstanding concept raised in past discussions on how to apply the AIA rules. But this concept has not benefited from a full discussion that took into consideration the divergent interests and views from all levels of the industry and from the cities. Thus, the worksession provided a forum for brainstorming and discussing the varied concerns, business implications, expected benefits and challenges of a formulary approach.

Worksession Highlights
There was general agreement that a formulary approach was preferable to the "list" approach used in Tacoma's AIA to identify the high alcohol content and low cost products banned from off-premises sales. Industry representatives indicated the list approach was undesirable because it was too subjective, lacked predictability and made product management difficult. Thus, a formula approach could better satisfy the need for greater certainty and uniformity.

At the start of the worksession, some industry participants were reluctant to discuss a formula approach that would include a price element. However, by the second day of the worksession, the discussion evolved to a meaningful discourse on the pros and cons of such approach. The price element was discussed with respect to regulatory control at the wholesale level as well as at the retail level. As the concept was explored more fully, it became evident that the price element had many implementation challenges because of monthly and promotional price changes.

Further, the fact that multiple wholesalers may be selling the same product at different prices could result in some falling within and others outside of the formula. This situation could result in the possibility that a retailer within an AIA could permissibly buy the product from a wholesaler pricing outside the formula and, consequently, sell the product without violating the AIA restriction. Such possibility, of course, would contravene the purpose of the AIA designation and restrictions. Thus, implementation and enforcement issues remain significant and unresolved.

With respect to a formula that only contains the alcohol content element, there was consensus from industry representatives that a 5.7% alcohol content by volume restriction for beer products was agreeable. Seattle and Tacoma representatives believed it should be lower but did not specify a particular alcohol content level.

Wine products have been less of an issue than beer. The Wine Institute representative stated that using a list of named products was preferable to a formula approach. The cities indicated their preference for a formula that included an 11% alcohol content by volume.

In sum, the worksession was valuable to help identify some benefits and limitations of a formula approach. Clearly there was increased understanding on the part of the participants of each others' business concerns. Because there are significant implementation and enforcement limitations with the price element, an alcohol content-to-price formula approach would need more exploration and discussion before it could be an effective means of identifying products restricted under the AIA rules.

As a final note, I would like to acknowledge the excellent facilitation services provided by Kathy Baros-Friedt, who was effective in keeping the participants focused and engaged.

Please let me know if you have any questions or if there is additional information I can provide about the worksession.

MINUTES OF AIA FORMULA WORKSESSION JANUARY 17, 2003

WORKSESSION STARTED: 10:00 a.m.

Kathy Baros Friedt, facilitator, announced that Lorraine Lee, Licensing Director, will start the meeting off with a continuation of proposals from the last meeting of January 10th.

Kathy related implementation issues and referenced back to flip chart issues. She said it might be easier to look at the minutes of January 10th, and study implications of formula implementation questions that remain. Kathy noted that hopefully they would wrap up the discussion.

The Active participants introduced themselves as follows:

Andrew Baldonado, Anheuser Busch Co.
Stuart Halson, representing Coors Brewing Co.
Steve Gano, representing Miller Brewing Co.
Syd Abrams, Wine Institute
Phil Wayt, Washington Beer and Wine Wholesalers Association
Danny Olson, McKenzie River Corporation
Kyong Ho Hwangpo, Korean-American Grocers Retail Association
T. K. Bentler, Washington Association of Neighborhood Stores
Holly Chisa, Washington Food Industry
Greg Hopkins, City of Tacoma
Phil Brenneman, City of Seattle
Lorraine Lee, WSLCB
Rick Garza, WSLCB
Randy Reynolds, WSLCB
Kathy Baros Friedt, Facilitator
Sherry Frederick, WSLCB-Recorder

The audience members were also asked to introduce themselves and their names are reflected on the sign-in list.

Lorraine welcomed everyone to part two of the AIA worksession, and gave a recap of the last meeting. She noted the participants were invited for the purpose of developing an alcohol content and price formula as one approach to the AIA issue. Lorraine said she believed the formula approach is worth exploring and would deliver more consistency in application of a product restriction under the AIA rules.

Lorraine also noted that it is important to explore the formula approach. She said there have been discussions for a few years about the formula approach. She said that we need to see if there is agreement regarding an alcohol and price component. Lorraine noted that just alcohol content might be "overboard". As noted during the last meeting, if the

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threshold of 5.7 percent alcohol content was set, it would impact some 600 products, so it is believed price component is important to narrow the list of restricted products.

Lorraine also referenced the timeline handed out in the last meeting, milestones, and an upcoming study of Tacoma AIA to see how well the rules have worked. She reviewed the elements of the Tacoma AIA study. She stated that she does not believe the restrictions alone can solve the CPI problem. Lorraine noted that an independent contractor would conduct the study.

Lorraine emphasized that the purpose of the worksession was to capture the participants' views and see if together, using collective brainpower, sort through issues related to a formula approach. Lorraine said that having everyone together was beneficial and she wanted to approach today's session with that in mind.

Lorraine restated they were here to look at the formula approach, and identify products that would be banned from sale in an AIA. She said they wanted to keep it at that narrow of focus. She noted the AIA rules were still in the early stages of implementation; they wanted to explore whether a formula approach was workable and what it would look like. Lorraine said she wanted to start exploring specific proposals.

Kathy thanked Lorraine for her summary. She referred to three proposals from the last meeting:

1. 5.7 percent alcohol and 4 cents per ounce.
2. Lower percent/increase cost.
3. Cost per retail ounce; Board staff would like to spend some time to capture why this would or would not be workable.

FLIPCHART
SPECIFIC PROPOSALS

1. **Revisit cost/retail oz**
2. **Greater than 5.7% alcohol; less than 4 cents/oz**
3. **Greater than 5.4% alcohol; less than 8 cents/oz**
4. **Greater than 5.5% alcohol only**
5. **Greater than 5.7% alcohol only**

Lorraine asked, in regard to specific proposals, about retail price per ounce. She noted the cost element matters to the CPI, why not look at retail price per ounce?

A handout, AIA Formula (Alcohol Content by Vol & Retail Price Per Oz), was circulated pointing out how this proposal may be approached.

FLIPCHART
COST/RETAIL OZ
Pros:

- **Can use price-posting system**
- **Enforcement agents can do spot checks**

- **Ability for LCB to set a "floor" for prices**
- **Not anti-trust, if LCB sets**
- **Seems lesser restriction**
- **Could LCB set/calculate individual price? Remove that burden from retail**
- **Would give more info to consumer**

Cons:

- **Need rule change regarding content on label**
- **Would need to post prices at store**
- **Can't monitor at LCB level**
- **Difficult for retailer to post at single price**
- **Would rather keep existing than go this way**
- **Take statutory authority to require content on can**
- **Prices change each month; change @ one difficult for young clerks to math @ mo**
- **Impractical**
- **Labeling nightmare for wholesaler; external packaging as well**

Discussion followed concerning how difficult calculations would be. Lorraine noted it would set a floor for pricing. Participants discussed the issue of alcohol content on labels, including what requirements would be concerning labeling individual product.

Greg asked why do wine and distilled spirits products have alcohol content on their labels. Stu noted it is because of a policy decision that was made to show on the product what was higher alcohol content.

Syd indicated the industry was split on labeling. Wine is not an issue, lower alcohol content means sweeter rather than dryer. It was noted the beer industry/specifically Coors, went to court over this issue and prevailed to have the ability to include alcohol content on the label. But it is the producer's choice whether to put it on the label.

Danny noted that alcohol percentage would not just be on can, but on external packaging as well. Merchandisers going through an AIA would have a propensity to have a mix-up. He indicated mistakes happen, trying to work that much packaging for that neighborhood.

Phil B. said that if the industry didn't like the proposal, have us move into other direction; if it's a viable option, we will give comment.

Lorraine said she was just bouncing off ideas; she has information now of how it is not workable. She indicated they refocus on the price component using wholesale ounce.

Kathy said they would go to next proposal: greater than 5.7 percent alcohol by content/less than 4 cents per ounce. Kathy reviewed notes from the last meeting and the questions explored at the last meeting.

Kathy displayed a graph she put together regarding single can products banned because they fall within formula. Kathy noted single can products not within the formula would

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not be banned. She said it would be the local jurisdiction's burden of proof/reasonable link to include a product that does not fall within the formula. It was also noted that single can products not falling within formula would not be banned. Higher cost products would probably not be CPI choice.

Kathy asked for comments on the proposal of 5.7 percent alcohol by volume/4 cents per ounce. Discussion followed regarding alcohol volume baseline for formula as well as cost and CPI, and what they buy (social implications).

Carrying over from the last session was a discussion specifically to 5.4 percent alcohol by volume and 8 cents per ounce. Some had felt that the % hadn't sufficiently captured the targeted beverages and that the 4 cents/ oz. too low; was an old number. Discussion resumed with this proposal.

FLIPCHART
<u>GREATER THAN 5.4% ALCOHOL & LESS THAN 8 CENTS/OZ</u>
Pros:

1. **Want formula that covers appropriate products/more appropriate list**
2. **5.5 seems good baseline/majority is 5.4, 5.5**
3. **Success factor: less drunk CPI**

FLIPCHART
<u>GREATER THAN 5.4% ALCOHOL AND LESS 8 CENTS/OZ</u>
Cons:

1. **Market is really 5.9% and greater**
2. **Opposed to price concept itself**
3. **Need mechanism to add or delete products**

There was discussion regarding percentage, mechanism to add and delete products, reasonable link process, problems for industry if different lists for different AIAs. Kathy noted that many had indicated that a list was unmanageable and all parties were striving for something more consistent. It was reiterated that, the LCB feels strongly about both elements of formula. She noted that if they (the participants) wanted to influence the LCB's outcome, this forum was an opportunity to take advantage of documenting how they felt about both elements, and why.

Lorraine stated: if there is something we haven't heard about, we need to hear it. Holly said that they have no parameters; they were trying to create a box. She said she could live with a formula, that cost won't work, that with reasonable link she would have a threshold (Stu interjected "A safe harbor").

Kathy asked how only one element would create a boundary. Holly said "reasonable link". Danny asked: if they have percentage and ability to ban why do they need price?

Discussion ensured pertaining to the list, products to ban, and the industry's feeling that reasonable link will work with alcohol content.

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Lorraine said that they need same elements or approach for all AIAs. She noted, however, it is doable to do other way, but not the preferred approach. She said they would have a review period for whole AIA approach, that whatever is implemented is a test period, a work in progress.

Phil W. brought up discussion pertaining to the February 6th worksession for the Seattle AIA, and the review period coming up for Tacoma AIA. Lorraine said that Seattle's designation wouldn't be impacted by Tacoma.

FLIPCHART
<u>EFFECT OF SHIFTING COST</u>

- **5.8% & greater/4 cents and less – 1101 different products**
- **5.8% & greater/5 cents and less – 2600 total products**
- **5.8 %/6 cents/oz and less – 3843 total products**

Break for lunch: 11:35 a.m.

Worksession Resumed: 12:48 p.m.

Kathy noted to the participants that she wanted to capture for the LCB, why the industry feels that applying alcohol percent only <u>is</u> manageable.

FLIPCHART
<u>PROPOSAL: 5.5% AND GREATER & NO $</u>

1. **Too broad to adequately identify CPI product**
2. **Too broad to adequately identify what is <u>not</u> CPI product**
3. **Labor intensive to go through <u>all</u> brands under 5.5 percent**
4. **Make list mainstream – as OK to sell**
5. **5.7% more relevant**
6. **"Ice beer" higher alcohol content (5.7%)**
7. **Cost gets into packaging issues**
8. **Does remove CPI products (generally 5.9% and greater)**
9. **78% of products on chart are between 4-6%**
10. **Mainstream: broad geographic representation**
11. **Jeopardizing wholesalers ability to sell**

Mark Greenberg of Anheuser-Busch said we don't agree that if you ban products at certain prices, the CPI will go away. All you are doing is raising cost; the products would be replaced by a higher priced product. Andrew noted that: "You are putting us into a competitive position with the state, they (CPIs) could buy a cheap bottle of Vodka".

Phil B. said that if the product is identified by formula, the Board is saying there is a reasonable link between the formula and problems. There is an identified group of products. There would be a list for a period of time where your products won't get put on by diluting or changing price.

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FLIPCHART
<u>IMPLEMENTATION ISSUES</u>

1. **Length of time product banned**
2. **Effect of rogue distributor posting (statewide)**
3. **New products?**
4. **Process for removing products from list?**
5. **Products on list which don't fall within formula?**
6. **Criteria for reasonable link?**
7. **Which posting would be the "snapshot?"**
8. **Effect of product promos?**
9. **Where's implementation burden?**

Kathy asked what was the LCB proposal on length of time banned. Lorraine responded that it was one year.

Discussion ensued pertaining to price posting process, with input from Phil W. regarding distributor geographical areas (not LCB requirement) based on agreements between suppliers and distributors.

FLIPCHART
<u>QUESTION FOR IMPLEMENTATION</u>
1. **Length of time product banned?**
   - **1 year**
   - **standard @ AIA (statewide)**
   - **1 list throughout state**
   - **Uniform/consistently applied**
   - **Concern: different across AIAs**
   - **May be different lists to manage**
   - **Assessed at end of AIA 2-year re-evaluation period**

FLIPCHART
2. **Effect of distributor posts own price & generates formula being applied**
   - **Not a problem**
   - **Would undercut industry and process**
   - **Unlikely to happen**
   - **Concerned continually upping price affects all buyers, even mainstream**
   - **Which posting would be the snapshot?**
   - **"Frontline" selling price**
   - **4-month period, what LCB has now**
   - **"Post-off" be within formula (70% products)**
   - **Timing of getting on list/off list for one year**

Randy explained "frontline" selling price. A discussion of problems concerning putting product on sale and running a brand sale with retailer ensued. National promotions would impact products that can't be sold in AIA.

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Lorraine discussed the price element, and how it would apply:

FLIPCHART
<u>PRICE ELEMENT</u>
How apply?

- **Price – at what point in time?**
- **Multi distributors, different prices**

One year:

- **5.7% & 6 cents ounce, Brand A**
- **September: Brand B – 5.7% & 8 cents**
- **October: Brand B – 5.7% & 5 cents**

Discussion followed pertaining to one-year stability of list, so product may be placed on sale. The city can't adjust for one year for a sale. Danny noted that even if a distributor posted every other month, the cents per ounce formula would be unbelievable; let it just be 5.7 percent.

FLIPCHART (cont. of Price Element)

- **Everyone will find a way around the cents/ounce**
- **Industry will continue to shift**
- **Will purchase quantity during price post-off "buy in's"**
- **Consider price posting – monthly?**
- **Consider discussion on price and singles**
- **Clearer criteria regarding reasonable link**

Randy noted that all information for placement of product in formula would be from price-posting system, the frontline selling price, not post-offs. It will be based on regular price (four-month period of time). Discussion ensued concerning potential of manipulation of prices to fall out of formula. Phil W. shared information concerning price posting, "post-off specials", and ad specials. It was noted that consumers would have to pay a higher price in an AIA, even if that consumer was not a problem drinker. Lorraine asked if they would let formula drive how they price post. Phil W. said that they, the industry, wanted choice.

Lorraine gave a hypothetical formula, 5.7 percent and above 6 cents less wholesale ounce, noting this was a place to start thinking of implementation issues. Mark indicated that someone would introduce a new product that complies with formula.

Andrew asked if they could go without a price and if cities would be in agreement, asking how the LCB felt about this. Phil B. indicated there should be a price component geared to what CPIs drink, noting it is far from mainstream products they are drinking.

Kathy indicated she wanted to go down the table of participants, and ask each person to indicate how they felt about percent of alcohol by volume with a price component and/or if they had an issue they felt strongly about.

Holly Chisa voiced concern regarding "Implementation of what?" She noted participants were far apart, that there is an unwillingness to come together. She voiced that business concerns are not being addressed: implementation, price setting, how to deal with sales issue, not in agreement with basic formula.

T. K. Bentler indicated he was in favor of 5.7 percent.

Kyong Ho Hwangpo noted the single can issue was of concern; 5.7 percent is comfortable, price is uncomfortable, four cents presents challenges of implementation.

Danny Olson said that 5.7 percent is OK; the price component is not manageable. He noted the 5.7 percent limitation with reasonable link would equal fewer drunks.

Steve Gano indicated he supported the 5.7 percent proposal. He added that pricing complexity was a concern, as well as the single can issue. He also wanted a process for exceptions where a product could drop off the list.

Syd Abrams indicated he had no issues of concern to note.

Phil Brenneman noted that they didn't have numbers, the box was not filled in, he benefited from the frank discussion, and having been given LCB perspectives, and learning new perspectives in regard to the industry. He went on to note that things could be exempted from the formula; there could be a process for getting on or off the list.

Greg Hopkins indicated that the worksessions have been an education process. He stated that 5.7 percent was not their magic number, but a hair lower, as reflected in data submitted. He went on to state that they have concerns about single containers, but want to be reasonable. He emphasized that they, the cities, were concerned about market owners, noting they were taxpayers and helped pay their wages and were valuable members of the community. He added that the product list in place was effective for the city; reasonable link was a tool and cost component was tough to get a handle on.

Phil Wayt said they wouldn't argue about 5.7 percent if there were no price component.

Andrew Baldonado noted he wanted to clarify that Natural Ice was listed at 5.6 percent and that this was an error, it is brewed at 5.7 percent. He was not going to throw out 5.7 percent as a comfortable threshold. He noted he had issues with a price component, adding that he could live with 5.7 percent.

Stuart Halson indicated they could live with 5.7 percent, adding that a price component was unmanageable and unworkable. He voiced that the single serving container was most important issue, and he wanted to discuss no blanket single serve ban. He added that he supported Anheuser-Busch's position.

Rick Garza said that the Board was trying to deal with this issue for quite a while, hoping to get a formula of 5.7 percent, 6 percent, or something like that. The price discussion made him question if that was a right approach.

Randy Reynolds said that he was not concerned about which formula was adopted; products will come on or off the list if reasonable link is shown. He noted he was confused about how a formula would work, and price would be difficult to work if used price-posting system on a monthly basis.

Stu said that reasonable link was frustrating, demanding a burden of proof. Discussion followed concerning list and criteria for burden of proof (safe harbor) requirement by LCB.

Kathy then asked the participants where they were on wine. Kathy asked in what way the wine elements were different from beer. Syd noted that the wine industry prefers to just list banned products because there are so few products involved. Producers have said that if you don't want products in an area, we won't sell them there, voluntarily. Syd noted if the CPI were given housing, they wouldn't be "public". He (on behalf of the wine industry) asked: tell us what products you don't want, list is easiest, 16 percent and above, 10 cents or less by ounce, is OK.

FLIPCHART

<u>WINE</u>

- **13 percent and greater & 10 cents and lower**
- **Industry prefers list, as there are so few products**
- **Industry wants to meet with cities and together see what should be restricted**
- **16 percent and greater – 10 cents and lower Wine Institute Board at 11/02 meeting**
- **In Washington: MD 20/20; Thunderbird and Cisco**
- **City requests lists of 11 percent**
- **If use formula, use wholesale cost per ounce**

It was noted that the Washington Wine Institute likes the list concept; it is simple to show reasonable link with wine. Wine is less of an issue than beer is; their preference is to stick with a list. Holly noted that if a price element is done, it has to be standard to know what to work off of.

Kathy asked in the remaining time, focus remained on where to go next with remaining issues, such as implementation questions. Phil W. asked that they have the opportunity to get input from their groups before there is a public hearing on the issues raised in Seattle's AIA request. He was afraid there would be a worksession and the next week a public hearing, without knowing what's going to be on the table until the public hearing. He added that they needed meaningful reaction and input from their organizations.

Lorraine said information from this worksession would be shared with the Board Members, and would be factored in with the City of Seattle's request. Phil W. restated

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that they wanted some time to react, before a vote by the Board members. Lorraine responded that they could contact her. Discussion followed, with industry noting they wanted the Board to come back with a response to them before making a final decision.

Phil W. asked if on February 6, a recommendation would be made. Lorraine responded "no". She said that Board staff would lay out the pros and cons on using the formula approach; information from this worksession will be used as part of her presentation at the Board Work Session. The participants again asked that they be provided information of what direction the Board would be heading. Lorraine agreed to share with them her memo summarizing this worksession.

Kathy thanked the participants for their input.

Meeting ended at 2:50 p.m

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